



A REPORT  
TO THE  
MONTANA  
LEGISLATURE

FINANCIAL-COMPLIANCE AUDIT

*Department of  
Natural Resources and  
Conservation*

*For the Two Fiscal Years Ended  
June 30, 2016*

NOVEMBER 2016

LEGISLATIVE AUDIT  
DIVISION

16-17

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Financial-compliance audits are conducted by the Legislative Audit Division to determine whether an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) licenses.

The Single Audit Act Amendments of 1996 and the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards require the auditor to issue certain financial, internal control, and compliance reports in addition to those reports required by Government Auditing Standards. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2015, was issued March 29, 2016. The Single Audit Report for the two fiscal years ended June 30, 2017, will be issued by March 31, 2018. Copies of the Single Audit Report can be obtained by contacting:

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# LEGISLATIVE AUDIT DIVISION

Angus Maciver, Legislative Auditor  
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors:  
Cindy Jorgenson  
Joe Murray

November 2016

The Legislative Audit Committee  
of the Montana State Legislature:

This is our financial-compliance audit report on the Department of Natural Resources and Conservation (department) for the two fiscal years ended June 30, 2016. Included in this report are recommendations related to internal controls over land grant revenue distribution and compliance with state laws and policies.

During the audit we focused on transfers-in and transfers-out in the land grant trusts, activity in the State Revolving Fund programs, and investment earnings, as well as testing compliance with state laws and policies.

The department's written response to the audit recommendations is included in the audit report at page C-1. We thank the director and his staff for their cooperation and assistance throughout the audit.

Respectfully submitted,

*/s/ Angus Maciver*

Angus Maciver  
Legislative Auditor



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## ELECTED, APPOINTED AND ADMINISTRATIVE OFFICIALS

### **Administrative Officials**

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Ray Beck, Deputy Director

Kerry Davant, Chief of Staff

Danna Jackson, Chief Legal Counsel

Mark Bostrom, Administrator, Conservation and Resource Development  
Division

Bob Harrington, Administrator, Forestry Division

Jim Halvorson, Administrator, Oil and Gas Conservation Division

Tim Davis, Administrator, Water Resources Division

Shawn Thomas, Administrator, Trust Land Management Division

Tricia Greiberis, Chief Financial Officer

### **State Board of Land Commissioners**

Steve Bullock, Governor

Monica Lindeen, State Auditor

Linda McCulloch, Secretary of State

Denise Juneau, Superintendent of Public Instruction

Tim Fox, Attorney General

### **Boards, Commissions & Committees**

Board of Oil and Gas Conservation Commission

Reserved Water Rights Compact Commission

Drought and Water Supply Committee

Resource Conservation Advisory Council

Montana Grass Conservation Commission

St. Mary's Rehabilitation Working Group







# MONTANA LEGISLATIVE AUDIT DIVISION

## FINANCIAL-COMPLIANCE AUDIT

### Department of Natural Resources and Conservation

NOVEMBER 2016

16-17

REPORT SUMMARY

Our audit identified areas where the Department of Natural Resources and Conservation can strengthen controls related to trust land revenues, hydro-electric leases, review of accounting transactions, physical inventory of capital assets, and timeliness of the water permit process. We also recommended the department confirm all hydro-electric leases and improve documentation related to cash-like awards.

### Context

For fiscal years 2015-16 and 2014-15, the Department of Natural Resources and Conservation (department) generated distributable revenues through its management of state lands for 14 separate land trusts. The rentals, leases, and royalties decreased from \$75.6 million in fiscal year 2014 to \$65.8 million in fiscal year 2015 to \$59.5 million in fiscal year 2016. Most of the decrease relates to oil and gas activity as well as agricultural rentals. The decrease in oil and gas activity is related to low oil and gas prices. Grazing rentals and investment earnings increased.

During the audit we focused on personal services; revenues, transfers-in and transfers-out in the land grant trusts; activity in the State Revolving Fund programs; and investment earnings to support our opinion on the financial schedules. We also visited various land and regional offices responsible for trust lands, water resources, and oil and gas activities.

We tested laws related to department activity, including laws related to the Water Resource Division and state lands.

The department had \$19 million in accounts receivable from federal agencies at June 30,

2016, for fire-fighting costs incurred in previous years. Accounts receivables go back as far as calendar year 2012 due to the complexity of fire funding. The Fire Suppression account in the State Special Revenue Fund had a fund equity balance of \$73.7 million at June 30, 2016.

### Results

The current report contains eight recommendations related to:

- ♦ Improving internal controls over timber sales on trust lands.
- ♦ Entry and approval of accounting entries by the same person.
- ♦ Confirmation of hydro-electric revenue.
- ♦ Documentation of employee receipt of gift cards given as awards and documentation of related tax liability.
- ♦ Taking physical inventory of capital assets.
- ♦ Compliance with time frames in the water permitting process set by law.

We determined the schedules fairly present the activity of the department in all material

(continued on back)

respects. Therefore, the readers can rely on the financial schedules presented for fiscal years 2015-16 and 2014-15.

The department fully implemented the recommendation from the prior audit related to expenditure abatements.

Recommendation Concurrence	
Concur	5
Partially Concur	1
Conditionally Concur	2
Do Not Concur	0
<b>Source: Agency audit response included in final report.</b>	

For a complete copy of the report (16-17) or for further information, contact the Legislative Audit Division at 406-444-3122; e-mail to [lad@mt.gov](mailto:lad@mt.gov); or check the web site at <http://leg.mt.gov/audit>  
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# Chapter I – Introduction

## **Introduction**

We performed a financial-compliance audit of the Department of Natural Resources and Conservation (department) for the two fiscal years ended June 30, 2016.

The objectives of this audit were to:

1. Determine whether the department complied with selected state and federal laws and regulations.
2. Obtain an understanding of the department's internal controls to the extent necessary to support our audit of the department's financial schedules, and if appropriate, make recommendations for improvement in management and internal controls of the department.
3. Determine whether the department's financial schedules present fairly the results of operations and changes in fund equity and property held in trust for each of the two fiscal years ended June 30, 2016.
4. Determine the implementation status of prior audit recommendation.

During the audit we focused on personal services; revenues, transfers-in and transfers-out in the land grant trusts; activity in the State Revolving Fund programs; and investment earnings to support our opinion on the financial schedules. We also visited various district offices responsible for trust lands, water resources, and oil and gas activities. We tested laws related to the Water Resources Division and state lands.

We evaluated fees and charges for services in the Internal Service Fund as required by §17-8-101(6), MCA. We found the fees and charges were commensurate with costs and fund equity was reasonable for the Air Operations Program in fiscal years 2015-16 and 2014-15.

## **Background Information**

The department's mission is to help ensure that Montana's land and water resources provide benefits for present and future generations.

## **Department Organization**

The State Board of Land Commissioners, comprised of the Governor, State Auditor, Attorney General, Superintendent of Public Instruction, and Secretary of State exercises the general authority, direction, and control over the care, management, and disposition of state lands under its administration. The department's director is the chief administrative officer of the board.

The following descriptions of the department's six divisions include the number of budgeted full-time equivalent (FTE) positions in fiscal year 2015-16.

**Director's Office:** (57 FTE) administers, manages, plans, and evaluates agency functions in the areas of fiscal operations, human resources, information technology and public information, under the guidance of the director. The Director's Office includes the director's staff, Financial Services, Public Information, Legal Unit, Human Resources and Information Technology.

**Oil and Gas Conservation Division:** (20 FTE) administers the Montana oil and gas conservation laws. It promotes conservation and prevents waste in the recovery of oil and gas resources through regulation of exploration and production. The division issues drilling permits; classifies wells; establishes well spacing units and pooling orders; inspects drilling, production, and seismic operations; investigates complaints; and does engineering studies. The division also determines incremental production for enhanced recovery and horizontal wells in order to implement the tax incentive program for those projects, operates the underground injection control program, plugs orphan wells, and collects and maintains complete well data and production information. The division provides administrative support to the Board of Oil and Gas Conservation.

**Conservation and Resource Development Division:** (27.17 FTE) assists local entities in managing the state's natural resources and provides financing for conservation resource management and reclamation activities. The division is made up of three bureaus. The Conservation Districts Bureau provides technical, administrative, financial, and legal assistance to Montana's 58 conservation districts. The Financial Bureau issues loans for local communities, local governments, state agencies, and private citizens. The programs include State Revolving Fund loans to communities for drinking water and waste water systems, Coal Severance Tax loans to governmental entities, and loans to private entities for water development projects. Loans outstanding exceed \$400 million at June 30, 2016. Grant programs administered by the Resource Development Bureau include the Reclamation and Development, Renewable Resource, and Conservation District grant programs.

**Water Resources Division:** (134.30 FTE) is responsible for programs associated with the use, development, and protection of Montana's water. It manages and maintains state-owned dams, reservoirs, and canals. The division develops and recommends intrastate, interstate, and international water policy to the director, governor, and legislature. They released an updated "Montana State Water Plan" in 2015. The division also resolves water resource use conflicts, investigates water use violations, ensures dam safety compliance, and provides water adjudication support to the Water Court.

The division consists of an administration unit and five bureaus: Water Adjudication Bureau, Water Management Bureau, Water Rights Bureau, Water Projects Bureau, and Water Operations Bureau.

The Reserved Water Rights Compact Commission is attached to the department for administrative purposes. The commission, budgeted for 4.75 FTE positions, is authorized to negotiate settlements with Montana Indian tribes and federal agencies claiming reserved water rights within the state of Montana.

**Forestry/Trust Land Management Division:** (312.04 FTE) manages the forest resources of the state and state lands held in trust to provide income for various state educational facilities and institutions. The department fulfills these responsibilities in two administrative units.

- ♦ **Forestry** is responsible for planning and implementing forestry programs statewide. The division protects Montana's natural resources from wildfire, regulates forest practices, and provides a variety of services to private forest landowners. The Fire and Aviation Management Program protects 50 million acres of state and private forest and watershed lands from wildfire through a combination of direct protection and county support. Annual fire suppression costs were approximately \$7 million in fiscal year 2015 and approximately \$19.1 million in fiscal year 2016, but have been as high as approximately \$71.4 million in fiscal year 2013.

The Forest Practice Regulation Program enforces Montana's streamside management zone regulations and monitors the voluntary best management practices program on all forests in Montana. In administering Montana's Fire Hazard Reduction Law, the division helps ensure fire hazards created by logging and other forest management operations on private forestlands are adequately reduced, or that additional fire protection is provided until the hazard is reduced. The division provides technical forestry assistance to private landowners, businesses, and communities.

- ♦ **Trust Land Management** provides for the administration and management of trust lands granted to the state of Montana by the Enabling Act of 1889. In the process of producing revenue for trust beneficiaries, the division considers environmental factors and the future income-generating capacity of the trust lands. These lands currently total over 5.1 million surface acres and 6.2 million mineral acres. Additionally, the division is responsible for the administration of approximately 3,412 miles of the beds of navigable waterways. The Trust Land Management Division is divided into four primary programs: forest management, agriculture and grazing management, real estate management, and minerals management.

Table 1

**Examples of Trust Land Income Earned in the Audit Period**

(In millions, rounded to the nearest hundred thousand dollars)

Examples of Revenue Earned by Each Program	FY15	FY16
Forest Management Timber Sales	\$10.3	\$7.3
Ag and Grazing Management Ag and Grazing Rentals	\$28.9	\$31.9
Real Estate Management Right of Way	\$5.3	\$1.9
Minerals Management Oil and Coal Royalties	\$21.4	\$16.5

**Source: Compiled by the Legislative Audit Division.**

## Changes in Trust Land Revenue

The trust funds had an increase of approximately \$21 million in revenue in fiscal year 2016 due to the increases in the fair value of investments held in the trust fund bond pool. However, the rentals, leases, and royalties decreased as shown in Table 2. Most of the decrease is due to a decrease in oil and gas leases, oil and gas bonus payments, and oil royalties. Agricultural rentals also decreased both years while grazing rentals and investment earnings increased. Oil and gas decreases are related to low oil and gas prices.

Table 2

**State Land Revenue**

(In millions, rounded to the nearest hundred thousand dollars)

	FY13	FY14	FY15	FY16
Rental, Leases, and Royalties in the Permanent Fund	\$74.4	\$75.6	\$65.8	\$59.5
Investment Earnings	\$9.5	\$34.8	\$20.5	\$45.0

**Source: Compiled by the Legislative Audit Division.**

## Sage Grouse Activity

Sage grouse management was a new department responsibility in fiscal year 2016. The Montana Greater Sage-Grouse Stewardship Act created the Sage Grouse Stewardship Account and the Sage Grouse Habitat Conservation Oversight Team. The account's purpose is to grant money to protect Sage Grouse Habitat. In addition, there will be a habitat quantification tool developed. The tool will be a mechanism to ensure sage grouse habitats are protected.

There were no funds expended from the Sage Grouse Stewardship Account in fiscal year 2016. The Montana Sage Grouse Oversight Team considered the first round of grant applications. The team is administratively attached to the Governor's Office.

The Sage Grouse Habitat Conservation Program was created by the Executive Order No. 12-2015. Applications must be submitted by anyone proposing new activities in sage grouse habitats requiring a permit from a state agency or where state funding is requested. State agencies with activities in sage grouse habitats also submit applications. The Sage Grouse Habitat Conservation Program reviews these project applications.

### **Prior Audit Recommendation**

We performed the prior audit of the department for the two fiscal years ended June 30, 2014. The department implemented the prior audit recommendation related to expenditure abatements. The department is no longer recording expenditure abatement for expected reimbursements.





## Chapter II – Findings and Recommendations

### **Internal Controls**

State accounting policy requires state agencies to implement internal control procedures. A control structure is a process designed to provide management with reasonable assurance it will achieve its objectives related to financial accountability and compliance with laws and regulations. Deficiencies in internal controls increase the risk an agency may not identify inappropriate or inaccurate transactions in a timely manner or be able to ensure the financial schedules are free from misstatement. The following three sections describe areas where the Department of Natural Resources and Conservation (department) can make improvements in internal controls.

### **Land Grant Revenue**

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**The department can enhance internal controls related to accounting for state land trust revenue and State Revolving Fund programs.**

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The department manages Montana trust land for the benefit of 14 separate trusts such as Common Schools and University trusts. Under Montana law, the department has a duty of complete loyalty to each trust, for the sole interest of each trust's beneficiaries.

The department uses the Trust Land Management System (TLMS) to track trust revenues. The coding in TLMS determines how revenues will be recorded in the state's accounting system, including the trust to which the funds are credited. Revenues could be collected up front or over a period of several years depending on the underlying agreement.

### **Timber Sales and Easements**

During our audit, we tested revenue transactions comprised of timber sales and easements on state lands. Timber Sale revenue was over \$10 million in fiscal year 2015 and over \$7 million in fiscal year 2016. Easements were over \$5 million in fiscal year 2015 and over \$1.8 million in fiscal year 2016. In a statistical sample, of 32 items tested, we found the following errors:

- ♦ One timber sale agreement was established in TLMS to the credit of the wrong trust. As a result, multiple revenue collections were recorded on the state's accounting system incorrectly. In total, the department distributed \$71,072 too much to Common Schools and too little to Capitol Buildings trust in fiscal year 2015. Department staff noted the final timber sale review may have identified the error. However, a review at the end of a multiple year sale does not allow for timely identification and correction of trust revenue coding errors.

- ♦ Documentation to support the agreed-upon price was not available for one timber permit and one limited access timber sale. For the timber permit, the signed contract was not retained. Without documentation, the department is not able to demonstrate its compliance with applicable state laws related to fair value of limited timber sales and timber permits.

The department should design internal controls to verify the accuracy of timber sales information in TLMS upon input, and to ensure documentation supporting timber permits and limited timber sales is retained.

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#### **RECOMMENDATION #1**

*We recommend the Department of Natural Resources and Conservation implement internal controls to:*

- A. *Review information input to the Trust Land Management System prior to distributing any timber sales revenue to the trusts.*
  - B. *Retain documentation, including the related contracts, supporting timber permits and limited access timber sales.*
- 

## **Land Grant Transfers**

Between July 2014 and March 2016, one member of the department's accounting staff entered and approved Land Grant transfers and preformed the reconciliations of the transactions. These transactions involve millions of dollars at a time. For example, the Common School transfers to the guarantee fund was over \$48 million in fiscal year 2015 and the Transfers-In for trust administration was over \$12 million in fiscal year 2015. State policy requires segregation of duties in the following areas: authorizing transactions, recording transactions, and reviewing and reconciling the related items. We communicated this to the department and they now have three staff members involved in the transfers. One staff member completes the distribution spreadsheets, another staff member runs data mine reports and verifies the amounts on the spreadsheets, a third enters the journals into the state's accounting system, and then the first staff member approves the entries. We considered the lack of segregation of duties in determining the extent of our testing and while we did not identify any errors, the risk of an error occurring and remaining undetected existed during the audit period.

## State Revolving Fund Program and Blackfoot Mitigation Account

Other accounting entries at the department can be entered and approved by the same person. This includes large transactions such as entries made for the State Revolving Fund Programs (SRF) and the Blackfoot Mitigation account. In fiscal year 2016, we identified the following misclassifications:

- ♦ Cash with Fiscal Agent was overstated and Cash Equivalent administered by agencies was understated by approximately \$16 million in the state special revenue fund, SRF programs
- ♦ Short-term investments was overstated by approximately \$9 million and long-term investments understated by the same amount in the state special revenue fund, Blackfoot Mitigation account.

The above errors do not affect the financial schedules contained in this report as they are related to the classification of asset accounts. Total assets were not misstated so fund equity is not affected. However, without strengthened controls, other errors could occur that would affect the schedules.

After we communicated the errors, the department responded they will implement additional internal controls to review data input and approved by the same accountant.

### **RECOMMENDATION #2**

*We recommend the Department of Natural Resources and Conservation segregate accounting duties related to the approval and review of transactions as needed in order to prevent, detect, and correct accounting errors.*

## Hydro-Electric Lease Revenue

We tested revenue transactions comprised of the activity in Table 3. Of the 28 lease transactions tested, supporting documentation for one hydro-electric lease was not obtained from the lessor to support the amount of revenue remitted.

Table 3

**Total Revenue Earned Per Type of Trust Revenue**  
(In millions, rounded to the nearest hundred thousand dollars)

Type of Revenue	FY 15	FY 16
Agricultural	\$14.4	\$12.5
Grazing	\$14.5	\$19.5
Oil Royalties	\$13.5	\$7.4
Coal Royalties	\$7.9	\$9.1
Hydro-Electric Lease Revenue	\$4.6	\$4.6

**Source: Compiled by the Legislative Audit Division.**

There are three active hydro-electric leases: Bigfork Hydropower Project, Clark Fork Project, and Sweet Grass County Project. Payment for most leases are collected directly by the department. However, the lessee of one project calculates hydro-electric lease revenue based on criteria in the lease. The lessee remitted \$45,720 total in fiscal years 2015 and 2016.

Per department staff, they are unable to recalculate revenue for one of the hydro-electric leases because they are unable to obtain necessary supporting documentation from the lessee for both fiscal years 2015 and 2016. Without further information, the department is unable to confirm the accuracy and completeness of the revenue.

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**RECOMMENDATION #3**

*We recommend the Department of Natural Resources and Conservation amend the agreement with the lessee if they are unable to confirm the accuracy and completeness of hydro-electric lease revenue.*

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## **Employee Awards**

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### **The department can improve internal controls and compliance with federal tax regulations related to employee awards.**

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Department policy allows for a variety of annual awards for employee recognition purposes. There were \$11,019 in the “rewards expenses” account in fiscal year 2015 and \$29,570 in fiscal year 2016. The rewards expenses were not all gift cards. Almost \$18,000 of the rewards expenses in fiscal year 2016 were commemorative coins for the calendar year 2015 fire season. During the audit, we reviewed the purchase \$950 worth of gift cards. The department documented the employees for whom gift cards were purchased, but the employees did not sign for receipt of the awards. Gift cards have value to anyone possessing them. Without documentation to confirm the intended recipients received the awards, the department is at risk of awards being misused by staff involved in the process.

Further, federal tax law require awards like gift cards from an employer be included as taxable income on the receiving employee’s W-2 form because cash and cash equivalents are always considered income. The department could not produce evidence that these awards were properly reported to the federal Internal Revenue Service.

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**RECOMMENDATION #4**

*We recommend the Department of Natural Resources and Conservation:*

- A. *Implement procedures to document receipt of cash-like awards, and*
  - B. *Comply with federal tax law governing inclusion of gifts in employee income as required by the Internal Revenue Service.*
- 

## **Capital Asset Inventory**

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**The department did not complete a physical inventory as required by state policy.**

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The department has not completed an annual inventory since fiscal year 2013. State accounting policy requires an agency to “take a complete physical inventory of all capital assets, tagged minor equipment, and sensitive equipment” at least every two years. The position that handled this task has been vacant since May 2014. Many of the over \$282.4 million in assets at the department are items that could not be moved because they are related to land or buildings. However, even with taking that into consideration, there are over \$21.6 million in other assets, including over \$20.7 million in assets that are not land or buildings that have not been inventoried in over 2 years. We communicated this noncompliance to the department and they filled the vacant position in May 2016 and are developing a plan to start an inventory schedule in fiscal year 2017.

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**RECOMMENDATION #5**

*We recommend the Department of Natural Resources and Conservation complete a physical inventory at least every two years as required by state policy.*

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## **Compliance With State Law**

The next three sections identify ways the department could improve compliance with state law.

### **Local Government Entitlement Payment and State Equalization Reporting**

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**There is state law requiring the department to file an outdated claim with the Department of Administration.**

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Chapter 574, Laws of 2001, a.k.a. the Big Bill, revised local government funding. During the audit, we tested the department's compliance with state land equalization reporting requirements. Per §77-1-504, MCA, "The department shall, before November 1 of each year, prepare and file a claim with the department of administration for all counties that are eligible for state land equalization amounts, and this claim must show the amount of money that each eligible county receives through the entitlement share provided for in 15-1-121."

The department staff noted they do not file a claim with the Department of Administration because it is no longer part of the process to complete this distribution. The state land equalization entitlement was relinquished by local governments in exchange for an entitlement share of the state general fund through Chapter 574, Laws of 2001.

Since the entitlement share laws were enacted, the department staff noted filing a claim was no longer necessary or practical. During the audit, we also reviewed related laws. For example, §§ 77-1-501 and 503, MCA, require the department to submit information to the Department of Revenue to compute the state land equalization amount. The department and the Department of Revenue comply with state law but reported the information is no longer being used for determining the payment of the entitlement share.

The department should work with the Department of Revenue and the Department of Administration to determine what statutory requirements are necessary in Title 77, Chapter 1, Part 5 to administer the entitlement share payments and comply with those requirements. If the departments identify any unnecessary requirements, they should seek legislation to eliminate those requirements.

**RECOMMENDATION #6**

*We recommend the Department of Natural Resources and Conservation:*

- A. *Comply with state law governing the local government entitlement share, or, if appropriate,*
- B. *Seek legislation to eliminate state equalization requirements no longer used for entitlement payment calculation.*

## **Surface and Groundwater Report**

**The department did not provide a water activity report annually to the Chippewa Cree Tribe and the United States as required by state law.**

Pursuant to Article IV(A)(5)(a) of the Chippewa Cree Tribe-Montana Compact, codified in §85-20-601, MCA: “On an annual basis DNRC shall provide the Tribe and the United States with a listing of all new uses of surface and groundwater for which a permit has been issued by DNRC in the Big Sandy and Beaver Creek Drainages, and of any change in use or transfer of surface water or groundwater approved by DNRC in the Big Sandy and Beaver Creek drainages since the last report.” A listing of all the new uses of surface and groundwater has not been prepared on an annual basis with the exception of fiscal year 2016. Department personnel indicated there has been staffing limitations at the department and turnover in the tribal’s water resource office that has attributed to the report not being completed. The report provides information on actions the state has taken regarding state-tested water rights as they relate to the compact.

**RECOMMENDATION #7**

*We recommend that the Department of Natural Resources and Conservation comply with state law by annually producing the required Surface and Ground Water Report.*

## Water Rights Permits

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### **The department did not meet all timelines related to the review of water permits required by state law.**

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The department is required to comply with timelines in the review of water permits. Our testing of state laws found the following instances of the department not meeting the timelines:

- ♦ Per §85-2-302(5), MCA, “The department shall notify the applicant of any defects in an application within 180 days. The defects must be identified by reference to the rules adopted under subsection (2). If the department does not notify the applicant of any defects within 180 days, the application must be treated as a correct and complete application.” In fiscal year 2016, there were 114 applications submitted under this section. Out of 114, there were 3 applications with defects where the applicant was not given a deficiency letter in 180 days. The applications were treated as correct and complete.
- ♦ Per §85-2-307(2)(ii), MCA, the department is required to make a written preliminary determination to satisfy applicable criteria for issuance of a permit or change in appropriation right within 120 days. In fiscal year 2015, there were 114 applications submitted and there was 1 application where the department did not make a written preliminary determination within 120 days.

Per department staff, the required general workload in the Water Resource Division caused the delays. Department staff noted they have a variety of duties including investigating complaints related to water rights and the division tries to juggle workload between offices when deadlines are approaching. The department increased automated reminders to department staff in order to meet all timelines in the future.

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### **RECOMMENDATION #8**

*We recommend that the Department of Natural Resources and Conservation comply with state law by adhering to timelines related to water permit reviews.*

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# **Independent Auditor's Report and Department Financial Schedules**



## LEGISLATIVE AUDIT DIVISION

Angus Maciver, Legislative Auditor  
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors:  
Cindy Jorgenson  
Joe Murray

## INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee  
of the Montana State Legislature:

### *Introduction*

We have audited the accompanying Schedules of Changes in Fund Equity & Property Held in Trust, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out of the Department of Natural Resources and Conservation for each of the fiscal years ended June 30, 2016 and 2015, and the related notes to the financial schedules.

### *Management's Responsibility for the Financial Schedules*

Management is responsible for the preparation and fair presentation of these financial schedules in accordance with the regulatory format prescribed by the Legislative Audit Committee, based on the transactions posted to the state's accounting system without adjustment; this responsibility includes recording transactions in accordance with state accounting policy; and designing, implementing, and maintaining internal controls relevant to the preparation and fair presentation of the financial schedules that are free from material misstatement, whether due to fraud or error.

### *Auditor's Responsibility*

Our responsibility is to express opinions on these financial schedules based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial schedules. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial schedules, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the department's preparation and fair presentation of the financial schedules in order to design audit procedures

that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the department's internal control, and accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as the overall presentation of the financial schedules.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

***Basis for Adverse Opinions on U.S. Generally Accepted Accounting Principles***

As described in Note 1, the financial schedules are prepared from the transactions posted to the state's primary accounting system without adjustment, in the regulatory format prescribed by the Legislative Audit Committee. This is a basis of accounting other than accounting principles generally accepted in the United States of America. The financial schedules are not intended to, and do not, report assets, liabilities, and cash flows.

The effects on the financial schedules of the variances between the regulatory basis of accounting described in Note 1 and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

***Adverse Opinions on U.S. Generally Accepted Accounting Principles***

In our opinion, because of the significance of the matter discussed in the "Basis for Adverse Opinions on U.S. Generally Accepted Accounting Principles" paragraph, the financial schedules referred to above do not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of the department as of June 30, 2016, and June 30, 2015, or changes in financial position or cash flows for the years then ended.

***Unmodified Opinions on Regulatory Basis of Accounting***

In our opinion, the Schedules of Changes in Fund Equity & Property Held in Trust, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out, presents fairly, in all material respects, the results of operations and changes in fund equity and property held in trust of the Department of Natural Resources and Conservation for each of the fiscal years ended June 30, 2016, and 2015, in conformity with the basis of accounting described in Note 1.

***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated September 22, 2016, on our consideration of the department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements

and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the department's internal control over financial reporting and compliance.

Respectfully submitted,

*/s/ Cindy Jorgenson*

Cindy Jorgenson, CPA  
Deputy Legislative Auditor  
Helena, MT

September 22, 2016



DEPARTMENT OF NATURAL RESOURCES AND CONSERVATION  
SCHEDULE OF CHANGES IN FUND EQUITY & PROPERTY HELD IN TRUST  
FOR THE FISCAL YEAR ENDED JUNE 30, 2016

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Enterprise Fund	Internal Service Fund	Agency Fund	Private Purpose Trust Fund	Permanent Fund
FUND EQUITY: July 1, 2015	\$ (18,165,897)	\$ 533,395,554	\$ (18,531,391)	\$ 36,956,393	\$ (138,743)	\$ (1,108,103)	\$ 0	\$ 1,083,614	\$ 667,182,914
PROPERTY HELD IN TRUST: July 1, 2015							\$ 1,736,440		
ADDITIONS									
Budgeted Revenues & Transfers-In	219,464	257,530,761	14,445,208		584,332	2,940,196			
Nonbudgeted Revenues & Transfers-In	445,103	51,512,664	1,222	22,342,173	5,209	20,619		547,050	162,720,819
Prior Year Revenues & Transfers-In Adjustments		(132,085)	(2,183)	(408)	462	10,715			
Direct Entries to Fund Equity	30,965,548	(37,555,603)	329,996	517,998		(5,052)			46,399
Additions to Property Held in Trust							8,516,967		
Total Additions	<u>31,630,115</u>	<u>271,355,737</u>	<u>14,774,243</u>	<u>22,859,763</u>	<u>590,003</u>	<u>2,966,478</u>	<u>8,516,967</u>	<u>547,050</u>	<u>162,767,218</u>
REDUCTIONS									
Budgeted Expenditures & Transfers-Out	28,379,297	50,606,108	17,459,647		573,911	2,418,598			
Nonbudgeted Expenditures & Transfers-Out	74,979	169,315,705	(2,851,711)	23,345,152	(22,566)	14,167		657,275	119,997,258
Prior Year Expenditures & Transfers-Out Adjustments	(15,379)	(1,610,713)	(2,042)		1,270	2,485			13,428
Reductions in Property Held in Trust							6,395,171		
Total Reductions	<u>28,438,896</u>	<u>218,311,100</u>	<u>14,605,894</u>	<u>23,345,152</u>	<u>552,615</u>	<u>2,435,250</u>	<u>6,395,171</u>	<u>657,275</u>	<u>120,010,686</u>
FUND EQUITY: June 30, 2016	\$ (14,974,678)	\$ 586,440,191	\$ (18,363,042)	\$ 36,471,004	\$ (101,355)	\$ (576,875)	\$ 0	\$ 973,389	\$ 709,939,446
PROPERTY HELD IN TRUST: June 30, 2016							\$ 3,858,236		

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.  
Additional information is provided in the notes to the financial schedules beginning on page A-9.

DEPARTMENT OF NATURAL RESOURCES AND CONSERVATION  
SCHEDULE OF CHANGES IN FUND EQUITY & PROPERTY HELD IN TRUST  
FOR THE FISCAL YEAR ENDED JUNE 30, 2015

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Enterprise Fund	Internal Service Fund	Agency Fund	Private Purpose Trust Fund	Permanent Fund
FUND EQUITY: July 1, 2014	\$ (25,697,678)	\$ 496,613,640	\$ (18,668,953)	\$ 38,166,633	\$ 38,457	\$ (140,781)	\$ 0	\$ 1,006,567	\$ 638,067,715
PROPERTY HELD IN TRUST: July 1, 2014							\$ 1,876,279		
ADDITIONS									
Budgeted Revenues & Transfers-In	109,340	226,632,685	9,680,231		567,754	2,017,845			
Nonbudgeted Revenues & Transfers-In	111,042	7,143,684	9,829	20,920,512	5,956	23,816		657,091	125,904,311
Prior Year Revenues & Transfers-In Adjustments	2,410	12,084	(30)	13,243	1,240	(2,088)			(8,789)
Direct Entries to Fund Equity	31,725,788	(38,205,620)	504,364	587,481	(229,190)	(998,122)			6,951
Additions to Property Held in Trust							1,438,563		
Total Additions	<u>31,948,580</u>	<u>195,582,833</u>	<u>10,194,394</u>	<u>21,521,236</u>	<u>345,760</u>	<u>1,041,451</u>	<u>1,438,563</u>	<u>657,091</u>	<u>125,902,473</u>
REDUCTIONS									
Budgeted Expenditures & Transfers-Out	24,407,666	68,001,505	13,271,361		512,124	1,986,206			
Nonbudgeted Expenditures & Transfers-Out	(8,190)	91,278,190	(3,229,393)	22,731,476	10,601	18,151		580,044	96,787,274
Prior Year Expenditures & Transfers-Out Adjustments	17,323	(478,776)	14,864		235	4,416			
Reductions in Property Held in Trust							1,578,402		
Total Reductions	<u>24,416,799</u>	<u>158,800,919</u>	<u>10,056,832</u>	<u>22,731,476</u>	<u>522,960</u>	<u>2,008,773</u>	<u>1,578,402</u>	<u>580,044</u>	<u>96,787,274</u>
FUND EQUITY: June 30, 2015	\$ (18,165,897)	\$ 533,395,554	\$ (18,531,391)	\$ 36,956,393	\$ (138,743)	\$ (1,108,103)	\$ 0	\$ 1,083,614	\$ 667,182,914
PROPERTY HELD IN TRUST: June 30, 2015							\$ 1,736,440		

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Additional information is provided in the notes to the financial schedules beginning on page A-9.



DEPARTMENT OF NATURAL RESOURCES AND CONSERVATION  
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN  
FOR THE FISCAL YEAR ENDED JUNE 30, 2016

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Enterprise Fund	Internal Service Fund	Private Purpose Trust Fund	Permanent Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS									
Licenses and Permits	\$ 600	\$ 262,570						\$ 1,525,589	\$ 1,788,759
Taxes		3,681,542	\$ 1,222						3,682,764
Charges for Services	102,075	3,868,100				\$ 1,503,988			5,474,163
Investment Earnings	15	3,275,317		\$ 8,495,929				44,967,197	56,738,458
Fines and Forfeits	15,245	248,656							263,901
Sale of Documents, Merchandise and Property	3,864	758,366		3,945,758	\$ 584,794			9,210,222	14,503,004
Rentals, Leases and Royalties	10,185	227,860						59,500,522	59,738,567
Grants, Contracts, and Donations		472,247			5,209	20,619	\$ 547,050	233	1,045,358
Transfers-in	349,253	296,051,218	10,489	9,900,078		1,446,923		44,913,858	352,671,819
Capital Asset Sale Proceeds	97,690	62,661	18,450					2,603,198	2,781,999
Inception of Lease/Installment Contract	81,433								81,433
Federal Indirect Cost Recoveries			396,496						396,496
Miscellaneous	4,207	2,803							7,010
Federal			14,017,590						14,017,590
Total Revenues & Transfers-In	664,567	308,911,340	14,444,247	22,341,765	590,003	2,971,530	547,050	162,720,819	513,191,321
Less: Nonbudgeted Revenues & Transfers-In	445,103	51,512,664	1,222	22,342,173	5,209	20,619	547,050	162,720,819	237,594,856
Prior Year Revenues & Transfers-In Adjustments		(132,085)	(2,183)	(408)	462	10,715			(123,499)
Actual Budgeted Revenues & Transfers-In	219,464	257,530,761	14,445,208	0	584,332	2,940,196	0	0	275,719,961
Estimated Revenues & Transfers-In	219,464	257,534,627	14,447,974		584,332	2,940,196			275,726,593
Budgeted Revenues & Transfers-In Over (Under) Estimated	\$ 0	\$ (3,866)	\$ (2,766)	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ (6,632)
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS									
Sale of Documents, Merchandise and Property		\$ (25)							\$ (25)
Transfers-in		(3,841)							(3,841)
Federal			(2,766)						(2,766)
Budgeted Revenues & Transfers-In Over (Under) Estimated	\$ 0	\$ (3,866)	\$ (2,766)	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ (6,632)

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.  
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DEPARTMENT OF NATURAL RESOURCES AND CONSERVATION  
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN  
FOR THE FISCAL YEAR ENDED JUNE 30, 2015

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Enterprise Fund	Internal Service Fund	Private Purpose Trust Fund	Permanent Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS									
Licenses and Permits		\$ 281,131						\$ 1,607,591	\$ 1,888,722
Taxes		3,635,155	\$ 1,079						3,636,234
Charges for Services	\$ 94,139	2,721,774		\$ 388		\$ 698,063			3,514,364
Investment Earnings		2,791,308		7,866,343				20,465,076	31,122,727
Fines and Forfeits	18,300	61,784						382	80,466
Monetary Settlements	201								201
Sale of Documents, Merchandise and Property	2,606	1,648,699		4,444,998	\$ 568,991			15,559,346	22,224,640
Rentals, Leases and Royalties	11,961	95,248						65,805,390	65,912,599
Grants, Contracts, and Donations		371,261	(82,430)		5,956	23,816	\$ 657,091	547	976,241
Transfers-in	19,278	194,883,678	137,729	8,622,026		1,317,694		20,812,109	225,792,514
Bond Proceeds		27,262,265							27,262,265
Capital Asset Sale Proceeds	69,232	30,350	8,750					1,645,081	1,753,413
Federal Indirect Cost Recoveries			237,008						237,008
Miscellaneous	7,075	5,800			3				12,879
Federal			9,387,894						9,387,894
Total Revenues & Transfers-In	222,792	233,788,453	9,690,030	20,933,755	574,950	2,039,573	657,091	125,895,522	393,802,166
Less: Nonbudgeted Revenues & Transfers-In	111,042	7,143,684	9,829	20,920,512	5,956	23,816	657,091	125,904,311	154,776,241
Prior Year Revenues & Transfers-In Adjustments	2,410	12,084	(30)	13,243	1,240	(2,088)		(8,789)	18,070
Actual Budgeted Revenues & Transfers-In	109,340	226,632,685	9,680,231	0	567,754	2,017,845	0	0	23,900,785
Estimated Revenues & Transfers-In	109,682	225,081,415	9,693,713		568,500	2,018,694			237,472,004
Budgeted Revenues & Transfers-In Over (Under) Estimated	\$ (342)	\$ 1,551,270	\$ (13,482)	\$ 0	\$ (746)	\$ (849)	\$ 0	\$ 0	\$ 1,535,851
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS									
Licenses and Permits		\$ (110)							\$ (110)
Charges for Services	\$ (142)	(7,725)				\$ (849)			(8,716)
Investment Earnings		(727,957)	\$ (40)						(727,997)
Fines and Forfeits	(200)	(834)							(1,034)
Sale of Documents, Merchandise and Property		(163)			\$ (249)				(412)
Rentals, Leases and Royalties		(112)							(112)
Transfers-in		2,289,752	(1)						2,289,751
Bond Proceeds		(36)							(36)
Capital Asset Sale Proceeds		(1,000)							(1,000)
Miscellaneous		(545)			(497)				(1,042)
Federal			(13,441)						(13,441)
Budgeted Revenues & Transfers-In Over (Under) Estimated	\$ (342)	\$ 1,551,270	\$ (13,482)	\$ 0	\$ (746)	\$ (849)	\$ 0	\$ 0	\$ 1,535,851

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-9.

DEPARTMENT OF NATURAL RESOURCES AND CONSERVATION  
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT  
FOR THE FISCAL YEAR ENDED JUNE 30, 2016

PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT	Conservation/Resource Development Division	Director's Office	Forestry/Trust Lands Division	Oil & Gas Conservation Division	Trust Funds	Water Resources Division	Total
Personal Services							
Salaries	\$ 1,634,729	\$ 3,185,547	\$ 14,773,073	\$ 985,825		\$ 7,190,828	\$ 27,770,002
Hourly Wages			5,907,667			4,211	5,911,878
Other Compensation	500			7,800		350	8,650
Employee Benefits	570,847	1,099,040	6,536,389	370,136		2,662,431	11,238,843
Personal Services-Other			22,217				22,217
Total	<u>2,206,076</u>	<u>4,284,587</u>	<u>27,239,346</u>	<u>1,363,761</u>		<u>9,857,820</u>	<u>44,951,590</u>
Operating Expenses							
Other Services	3,129,323	692,645	11,589,979	345,626		2,353,168	18,110,741
Supplies & Materials	177,425	448,569	2,547,197	52,292		359,401	3,584,884
Communications	47,939	221,859	684,294	58,716		227,976	1,240,784
Travel	109,165	48,270	1,255,273	37,223		142,223	1,592,154
Rent	139,566	183,492	4,183,658	33,584		679,591	52,198,891
Utilities	10,504	15,801	232,026	21,949		16,151	296,431
Repair & Maintenance	8,224	26,025	1,182,381	34,606		55,861	1,307,097
Other Expenses	102,833	79,825	742,933	40,537		559,632	1,525,760
Total	<u>3,724,979</u>	<u>1,716,486</u>	<u>22,417,741</u>	<u>624,533</u>		<u>4,394,003</u>	<u>32,877,742</u>
Equipment & Intangible Assets							
Equipment	10,711	110,925	1,945,854	29,983		170,084	2,267,557
Total	<u>10,711</u>	<u>110,925</u>	<u>1,945,854</u>	<u>29,983</u>		<u>170,084</u>	<u>2,267,557</u>
Capital Outlay							
Land & Interest In Land			24,267		\$ 2,990,000	1,729,783	4,744,050
Buildings			(39,154)				(39,154)
Total			<u>(14,887)</u>		<u>2,990,000</u>	<u>1,729,783</u>	<u>4,704,896</u>
Local Assistance							
Total							
Grants							
From State Sources	2,026,252		202,977				2,229,229
From Federal Sources			3,004,344				3,004,344
Total	<u>2,026,252</u>		<u>3,207,321</u>				<u>5,233,573</u>
Benefits & Claims							
From Other Sources			657,275				657,275
Other Financing Uses/Deduction	2,851,710						2,851,710
Total	<u>2,851,710</u>		<u>657,275</u>				<u>3,508,985</u>
Transfers-out							
Fund transfers	182,326,880	1,502,001	1,707,938		113,745,909	10,680	299,293,408
Intra-Entity Expense			40,721		3,739,976		3,780,697
Total	<u>182,326,880</u>	<u>1,502,001</u>	<u>1,748,659</u>		<u>117,485,885</u>	<u>10,680</u>	<u>303,074,105</u>
Debt Service							
Bonds	10,533,080						10,533,080
Loans	389,919					680,872	1,070,791
Capital Leases		27,144					27,144
Total	<u>10,922,999</u>	<u>27,144</u>				<u>680,872</u>	<u>11,631,015</u>
Post Employment Benefits							
Other Post Employment Benefits			49,000				49,000
Employer Pension Expense			58,405				58,405
Total			<u>107,405</u>				<u>107,405</u>
Total Expenditures & Transfers-Out	<u>\$ 204,069,607</u>	<u>\$ 7,641,143</u>	<u>\$ 57,308,714</u>	<u>\$ 2,018,277</u>	<u>\$ 120,475,885</u>	<u>\$ 16,843,242</u>	<u>\$ 408,356,868</u>
EXPENDITURES & TRANSFERS-OUT BY FUND							
General Fund	\$ 1,998,468	\$ 5,080,815	\$ 11,929,159			\$ 9,430,454	\$ 28,438,896
State Special Revenue Fund	178,281,693	2,246,521	29,804,261	\$ 1,912,042	\$ 465,199	5,601,384	218,311,100
Federal Special Revenue Fund	446,457	313,807	11,930,154	106,235		1,809,241	14,605,894
Debt Service Fund	23,342,989					2,163	23,345,152
Enterprise Fund			552,615				552,615
Internal Service Fund			2,435,250				2,435,250
Private Purpose Trust Fund			657,275				657,275
Permanent Fund					120,010,686		120,010,686
Total Expenditures & Transfers-Out	<u>204,069,607</u>	<u>7,641,143</u>	<u>57,308,714</u>	<u>2,018,277</u>	<u>120,475,885</u>	<u>16,843,242</u>	<u>408,356,868</u>
Less: Nonbudgeted Expenditures & Transfers-Out	188,498,509	79,310	871,898	4,143	120,462,457	613,940	310,530,257
Prior Year Expenditures & Transfers-Out Adjustments	(528,455)	(582)	(1,068,807)	2,028	13,428	(28,562)	(1,610,950)
Actual Budgeted Expenditures & Transfers-Out	<u>16,099,553</u>	<u>7,562,415</u>	<u>57,505,623</u>	<u>2,012,106</u>	<u>0</u>	<u>16,257,864</u>	<u>99,437,561</u>
Budget Authority	63,832,033	8,176,847	72,033,046	2,840,012		38,474,302	185,356,240
Unspent Budget Authority	<u>\$ 47,732,480</u>	<u>\$ 614,432</u>	<u>\$ 14,527,423</u>	<u>\$ 827,906</u>	<u>\$ 0</u>	<u>\$ 22,216,438</u>	<u>\$ 85,918,679</u>
UNSPENT BUDGET AUTHORITY BY FUND							
General Fund	\$ 567,812	\$ 562,181	\$ 451,996			\$ 482,939	\$ 2,064,928
State Special Revenue Fund	42,172,360	52,152	5,828,287	\$ 827,906		21,261,844	70,142,549
Federal Special Revenue Fund	4,992,308	99	8,103,244			471,655	13,567,306
Enterprise Fund			97,545				97,545
Internal Service Fund			46,351				46,351
Unspent Budget Authority	<u>\$ 47,732,480</u>	<u>\$ 614,432</u>	<u>\$ 14,527,423</u>	<u>\$ 827,906</u>	<u>\$ 0</u>	<u>\$ 22,216,438</u>	<u>\$ 85,918,679</u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.  
Additional information is provided in the notes to the financial schedules beginning on page A-9.

DEPARTMENT OF NATURAL RESOURCES AND CONSERVATION  
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT  
FOR THE FISCAL YEAR ENDED JUNE 30, 2015

A-10

PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT	Conservation/Resource Development Division	Director's Office	Forestry/Trust Lands Division	Oil & Gas Conservation Division	Trust Funds	Water Resources Division	Total
Personal Services							
Salaries	\$ 1,488,609	\$ 3,003,525	\$ 13,864,444	\$ 910,580		\$ 7,232,828	\$ 26,499,986
Hourly Wages			3,674,577			38,443	3,713,020
Other Compensation	374			8,150		8,898	17,422
Employee Benefits	520,425	1,034,465	5,917,222	319,472		2,642,179	10,433,763
Personal Services-Other			(44)				(44)
Total	2,009,408	4,037,990	23,456,199	1,238,202		9,922,348	40,664,147
Operating Expenses							
Other Services	14,545,686	509,871	5,387,725	1,073,632		1,842,621	23,359,535
Supplies & Materials	51,666	291,752	2,332,728	74,867		265,561	3,016,574
Communications	47,382	184,883	604,686	64,712		230,041	1,131,704
Travel	77,156	34,541	710,204	47,527		156,921	1,026,349
Rent	137,545	183,541	1,716,083	32,867		636,783	2,706,819
Utilities	10,894	16,550	226,142	22,077		15,972	291,635
Repair & Maintenance	9,237	12,314	895,042	27,228		65,295	1,009,116
Other Expenses	75,830	51,376	723,626	37,147		763,226	1,651,205
Total	14,955,396	1,284,828	12,596,236	1,380,057		3,976,420	34,192,937
Equipment & Intangible Assets							
Equipment	51,719	4,362	1,814,780	96,709		147,640	2,115,210
Intangible Assets		23,496					23,496
Total	51,719	27,858	1,814,780	96,709		147,640	2,138,706
Capital Outlay							
Land & Interest In Land					\$ 1,000,000	794,419	1,794,419
Buildings			185,000				185,000
Total			185,000		1,000,000	794,419	1,979,419
Local Assistance							
Total							
Grants							
From State Sources	14,515,483		3,045,974				17,561,457
From Federal Sources			2,758,901				2,758,901
Total	14,515,483		5,804,875				20,320,358
Benefits & Claims							
From Other Sources			580,045				580,045
Other Financing Uses/Deduction	3,229,393						3,229,393
Total	3,229,393		580,045				3,809,438
Transfers-out							
Fund transfers	104,161,830		1,917,576	1,350,000	90,436,672	1,068,596	198,934,674
Intra-Entity Expense			49,386		5,648,762		5,698,148
Total	104,161,830		1,966,962	1,350,000	96,085,434	1,068,596	204,632,822
Debt Service							
Bonds	6,853,227						6,853,227
Loans	401,357					751,306	1,152,663
Capital Leases		21,660					21,660
Total	7,254,584	21,660				751,306	8,027,550
Post Employment Benefits							
Other Post Employment Benefits			55,798				55,798
Employer Pension Expense			83,902				83,903
Total			139,700				139,700
Total Expenditures & Transfers-Out	\$ 146,177,813	\$ 5,372,336	\$ 46,543,797	\$ 4,064,968	\$ 97,085,434	\$ 16,660,729	\$ 315,905,077
EXPENDITURES & TRANSFERS-OUT BY FUND							
General Fund	\$ 1,269,006	\$ 3,158,113	\$ 11,188,159			\$ 8,801,521	\$ 24,416,799
State Special Revenue Fund	121,838,858	1,920,190	24,448,442	\$ 3,957,984	\$ 298,160	6,337,286	158,800,919
Federal Special Revenue Fund	341,388	294,033	7,795,420	106,984		1,519,007	10,056,832
Debt Service Fund	22,728,561					2,915	22,731,476
Enterprise Fund			522,960				522,960
Internal Service Fund			2,008,773				2,008,773
Private Purpose Trust Fund			580,044				580,044
Permanent Fund					96,787,274		96,787,274
Total Expenditures & Transfers-Out	146,177,813	5,372,336	46,543,797	4,064,968	97,085,434	16,660,729	315,905,077
Less: Nonbudgeted Expenditures & Transfers-Out	106,936,555	(2,462)	1,285,406	1,351,256	97,085,434	1,511,966	208,168,155
Prior Year Expenditures & Transfers-Out Adjustments	(6,209)		(416,486)	(18,944)		(18,327)	(441,940)
Actual Budgeted Expenditures & Transfers-Out	39,247,467	5,356,772	45,674,877	2,732,656	0	15,167,090	108,178,862
Budget Authority	46,008,153	5,828,819	56,282,641	3,783,554		34,346,546	146,249,713
Unspent Budget Authority	\$ 6,760,686	\$ 472,047	\$ 10,607,764	\$ 1,050,898	\$ 0	\$ 19,179,456	\$ 38,070,851
UNSPENT BUDGET AUTHORITY BY FUND							
General Fund	\$ 40,503	\$ 428,653	\$ 342,535			\$ 241,796	\$ 1,053,487
State Special Revenue Fund	3,519,050	9,891	994,586	\$ 1,050,793		18,347,512	23,921,832
Federal Special Revenue Fund	3,201,133	33,503	8,576,851	105		590,148	12,401,740
Enterprise Fund			177,555				177,555
Internal Service Fund			516,237				516,237
Unspent Budget Authority	\$ 6,760,686	\$ 472,047	\$ 10,607,764	\$ 1,050,898	\$ 0	\$ 19,179,456	\$ 38,070,851

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.  
Additional information is provided in the notes to the financial schedules beginning on page A-9.

# Department of Natural Resources and Conservation

## Notes to the Financial Schedules

### For the Two Fiscal Years Ended June 30, 2016

## 1. Summary of Significant Accounting Policies

### **Basis of Accounting**

The department uses the modified accrual basis of accounting, as defined by state accounting policy, for its Governmental fund category (General, State Special Revenue, Federal Special Revenue, Debt Service, and Permanent). In applying the modified accrual basis, the department records:

- ♦ Revenues when it receives cash or when receipts are realizable, measurable, earned, and available to pay current period liabilities.
- ♦ Expenditures for valid obligations when the department incurs the related liability and it is measurable, with the exception of the cost of employees' annual and sick leave. State accounting policy requires the department to record the cost of employees' annual and sick leave when used or paid.

The department uses accrual basis accounting for its Proprietary (Enterprise and Internal Service) and Fiduciary (Private-Purpose Trust and Agency) fund categories. Under the accrual basis, as defined by state accounting policy, the department records revenues in the accounting period when realizable, measurable, and earned, and records expenses in the period incurred when measurable.

Expenditures and expenses may include: entire budgeted service contracts even though the department receives the services in a subsequent fiscal year; goods ordered with a purchase order before fiscal year-end, but not received as of fiscal year-end; and equipment ordered with a purchase order before fiscal year-end.

### **Basis of Presentation**

The financial schedule format was adopted by the Legislative Audit Committee. The financial schedules are prepared from the transactions posted to the state's accounting system without adjustment.

The department uses the following funds:

### **Governmental Fund Category**

- ♦ **General Fund** – to account for all financial resources except those required to be accounted for in another fund. The department uses general funds for a portion of the operation of the Director's Office, Conservation & Resource Development Division, Water Resources Division, and Forestry Division.

In addition, general funds are used for conservation district grants and administration, fire pre-suppression and forest practices.

- ♦ **State Special Revenue Fund** – to account for proceeds of specific revenue sources (other than private-purpose trusts or major capital projects) that are legally restricted to expenditures for specific state program purposes. Department State Special Revenue Funds include forestry operations, Water Pollution Control and Drinking Water State Revolving Fund (SRF) Programs, Renewable Resource Grant and Loan Program, and trust lands administration.
- ♦ **Federal Special Revenue Fund** – to account for activities funded from federal revenue sources. Department Federal Special Revenue Funds include forest stewardship, fire operations and suppression efforts, and Water Pollution Control and Drinking Water SRF Programs, both financed in part by federal funds.
- ♦ **Debt Service Fund** – to account for accumulated resources for the payment of general long-term debt principal and interest. The department uses Debt Services Funds to account for Renewable Resources, Coal Severance Tax (CST) and Water Pollution Control and Drinking Water SRF Programs bond payments.
- ♦ **Permanent Fund** – to account for financial resources that are permanently restricted to the extent that only earnings, and not principal, may be used for purposes that support the department's programs. The department uses this fund for the Common School Trust, university and college trusts, School for the Deaf and Blind Trust, Pine Hills School Trust, Veteran's Home Trust, Public Land Trust, Lands Acquired Trust (Potomac Land), and the Trust and Legacy Account.

## Proprietary Fund Category

- ♦ **Internal Service Fund** – to account for the financing of goods or services provided by one department or agency to other departments or agencies of state government or to other governmental entities on a cost-reimbursement basis. The department Internal Service Fund contains the Forestry Division's Air Operations Program. The Air Operations Program maintains and operates aircraft to aid in fire suppression.
- ♦ **Enterprise Fund** – to account for operations (a) financed and operated in a manner similar to private business enterprises, where the Legislature intends that the department finance or recover costs primarily through user charges; (b) where the Legislature has decided that periodic determination of revenues earned, expenses incurred or net income is appropriate; (c) where the activity is financed solely by a pledge of the net revenues from fees and charges of the activity; or (d) when laws or regulations require that the activities' cost of providing services, including capital costs, be recovered with fees and charges rather than with taxes or similar revenues. The department accounts for the State Seedling Nursery Program in this fund.

## **Fiduciary Fund Category**

- ♦ **Private-Purpose Trust Fund** – to account for activity of any trust arrangement not properly reported in a pension fund or an investment trust fund where the principal and income benefit individuals, private organizations, or other governments. Department private-purpose trust fund is used to account for Fort Belknap Peoples Creek Minimum Flow funds set aside for the Fort Belknap-Montana Water Rights Compact, per §85-20-1007, MCA.
- ♦ **Agency Fund** – to account for resources held by the state in a custodial capacity. Agency funds may be used on a limited basis for internal (to the State) clearing account activity but these must have a zero balance at fiscal year-end. The department agency funds account for activity such as contractual bonds and hazard reduction.

## **2. General Fund Equity Balance**

The negative fund equity balance in the General Fund does not indicate overspent appropriation authority. The department has authority to pay obligations from the statewide General Fund within its appropriation limits. The department expends cash or other assets from the statewide fund when it pays General Fund obligations. The department's outstanding liabilities exceed the assets it has placed in the fund, resulting in negative ending General Fund equity balances for each of the fiscal years ended June 30, 2015 and June 30, 2016.

## **3. Direct Entries to Fund Equity**

Direct entries to fund equity in the General, State Special Revenue, Federal Special Revenue Fund, Debt Service and Permanent funds primarily include entries generated by SABHRS to reflect the flow of resources within individual funds shared by separate agencies.

Direct entries to fund equity in the enterprise and internal service funds are due to retroactive change mandated by the Governmental Accounting Standards Board (GASB) in conjunction with the requirement to address accounting and financial reporting for pensions. The department recorded to fund equity approximately \$266,000 in the enterprise fund in fiscal year 2014-15 to reflect entries from fiscal year 2012-13 and earlier and approximately \$1 million in the internal service fund in fiscal year 2014-15 to reflect entries from fiscal year 2012-13 and earlier.

## **4. Long-Term Debt**

In fiscal year 2015-16 and in prior fiscal years, the state of Montana issued General Obligation (GO) bonds for the Water Pollution Control and Drinking Water SRF Programs. The bond proceeds were used for Water Pollution Control and Drinking



Water project loans. At June 30, 2016, the department had a total of \$33,935,000 in GO bonds outstanding for these programs. The total GO bonds outstanding include a large bond issue in fiscal year 2014-15 of \$24,365,000 in the Water Pollution Control SRF program.

In fiscal year 2015-16 and in prior fiscal years, the state of Montana issued GO public and private bonds for the Renewable Resource Grant and Loan program. The bond proceeds were used for private loans for irrigation projects. At June 30, 2016, the department had a total of \$1,620,000 of GO public bonds and \$6,105,605 of GO private bonds outstanding for this program.

In fiscal year 2015-16 and in prior fiscal years, the department issued CST bonds for the Renewable Resource Grant and Loan program. The bond proceeds were used for public loans for irrigation, water, sewer and dam projects. At June 30, 2016, the department had a total of \$17,430,295 of CST bonds outstanding.

The department has a loan from the U.S. Bureau of Reclamation to fund the Middle Creek Dam project. The unpaid loan principal and interest during construction balance as of June 30, 2016, was \$2,199,958.

The Northern Cheyenne Tribe and the department entered into an agreement on July 1, 1994, in which the tribe agreed to loan the state up to \$11,500,000 of federal funds appropriated as part of the Northern Cheyenne Indian Reserved Water Rights Settlement. The noninterest bearing loan was used to help finance the costs of the Tongue River Dam Project. The actual amount of the loan was \$11,300,000. The outstanding loan balance at June 30, 2016, was \$6,374,359. In March 2005, the department issued CST bond to the tribe for \$9,851,282 as security for the loan. The bond, which is noninterest bearing, provides a means of repayment to the tribe in the event pledged revenues are insufficient for loan repayment.

## 5. Transfers-In

The Schedule of Total Revenues and Transfers-In contain the following activity in the transfers-in class:

- ♦ **General Fund** - This activity represents the transfer of the unreserved fund balance in the CST Shared State Special Revenue account per 15-35-108(3), MCA.
- ♦ **State Special Revenue Fund** – This activity represents:
  - ◊ the transfer of Common School Permanent Trust Fund earnings to the Guarantee Account for distribution to school districts;



- ◇ the transfer of trust earnings from permanent trust funds to earnings reserve;
- ◇ the transfer of grant funds and state funds from department divisions and other state agencies;
- ◇ the transfer of unspent loan proceeds to the fund that services the debt;
- ◇ the movement of loans receivable from other funds;
- ◇ the transfer of liability that was created when the Board of Investments (BOI) purchased a DNRC bond;
- ◇ the transfer of federal funds from the Department of Environmental Quality for the Water Pollution Control and Drinking Water SRF Programs;
- ◇ the transfer of funds from the trusts to administer state trust lands;
- ◇ the transfer of funds from the Broadwater Dam debt service fund in excess of the debt service requirement to the state projects hydro earnings fund;
- ◇ the transfer of funds from the GO Bond debt service fund in excess of the debt service requirement to the natural resources projects fund; and
- ◇ the transfers of funds per the 2013 Legislative Session House Bill 11 for the treasure state endowment regional water system account and 354 for the fire suppression account, and per the 2015 Legislative Session Senate Bill 57 to fund the water adjudication account and Senate Bill 418 to fund the natural resources operation account.
- ◆ **Federal Special Revenue Fund** – This activity is comprised of the transfer in of federal grant funds from other state agencies.
- ◆ **Debt Service Fund** – This activity is comprised of
  - ◇ the movement of loans receivable from other funds;
  - ◇ the transfers from debt service reserve, and
  - ◇ the transfers between debt services funds.
- ◆ **Internal Service Fund** – This activity represents the transfers from the general fund and fire protection tax fund for base funding of the air operations.
- ◆ **Permanent Fund** – This activity represents the distribution of interest & income and the allocation of the appreciation/depreciation of the Trust Fund Investment Pool within the trust funds administered by the department.

## 6. Transfers-Out

The Schedule of Total Expenditures and Transfers-Out contain the following activity in the transfers-in class:

- ◆ **Conservation/Resource Development Division** – This activity represents:
  - ◇ SRF transfers associated with the movement of loans receivable, sweeps and interest earnings to other funds;

- ◇ the movement of loans receivable to other funds;
- ◇ the transfer of liability that was created when the Board of Investments (BOI) purchased a DNRC bond;
- ◇ transfers of natural resource projects fund for House Bill 6, Renewable Resource Grants, and House Bill 7, Reclamation and Development Grants, to other department division and state agencies;
- ◇ the transfer of the unreserved fund balance in the CST Share State Special Revenue account per 15-35-108(3), MCA;
- ◇ the transfer of funds from the GO Bond debt service fund in excess of the debt service requirement to the natural resources projects fund;
- ◇ the transfer of funds from CST Bonds debt service funds in excess of the debt service requirement to the Montana Department of Revenue and the state projects hydro earnings account; and
- ◇ the transfers between debt service funds.
- ◆ **Directors Office** – This activity represents the transfer from the general fund to Water Resources Division.
- ◆ **Forestry/Trust Lands Division** – This activity represents:
  - ◇ the transfers from the general fund and fire protection tax fund for base funding of the air operations; and
  - ◇ the transfer from the general fund to the fire suppression fund per the 2013 Legislative Session House Bill 3.
- ◆ **Oil & Gas Conservation Division** – This activity represents the transfers of funds per the 2015 Legislative Session Senate Bill 418.
- ◆ **Trust Funds** – This activity represents:
  - ◇ the allocation of the appreciation/depreciation of the Trust Fund Investment Pool within the trust funds administered by the department;
  - ◇ the transfer of trust earnings from permanent trust funds to earnings reserve;
  - ◇ the transfer of funds from the trusts to administer state trust lands; and
  - ◇ the distribution of earnings to the trust permanent funds and the transfer of earnings to the trust beneficiaries.
- ◆ **Water Resources Division** – This activity represents:
  - ◇ the transfer of the balance of loan proceeds to the fund that services the debt; and
  - ◇ the transfer of state funds to other state agencies.

## 7. Fire Suppression Fund Revenues

The department receives transfer-in revenue to the fire suppression fund per 76-13-150, MCA, and the 2013 Legislative Session House Bill 354. In fiscal year 2014-15 the

department recorded revenue of \$3.7 million and in fiscal year 2015-16, the department recorded revenue of \$50.3 million.

## **8. SRF Program Transfers-In and Transfers-Out**

In fiscal year 2015-16, the SRF program saw an increase in transfer-in revenues and transfer-out expenditures over fiscal year 2014-15. This is primarily due to the substantial increase in loans in the SRF program. In fiscal year 2014-15, the program processed \$50.9 million in loans disbursements. In fiscal year 2015-16, the program processed \$85.8 million in loan disbursements, an increase of 35.9 million over the previous fiscal year.

## **9. Unspent Budget Authority**

The table below summarizes significant unspent budget authority by program. For fiscal year 2015-16, most amounts are related to biennial and continuing appropriations and the budget authority extends to fiscal year 2016-17.

<b><u>Unspent Budget Authority</u></b>		
	<b>FY 2014-15</b>	<b>Fy 2015-16</b>
<b>Conservation &amp; Resource Development Division</b>		
Bond Proceeds (various funds)	1,767,587	1,994,866
House Bill 8 CST Bonds		20,583,976
Natural Resources Projects		9,242,576
Sage Grouse Stewardship		5,000,000
SRF Federal Authority	3,129,986	4,959,475
Treasure State Endowment		3,962,240
<b>Water Resources Division</b>		
Blackfeet Mitigation	14,500,000	14,500,00
Broadwater R & R	938,638	1,000,000
State Projects Hydro Earnings	715,268	2,922,411
Water Project Loans	1,107,333	1,772,247
<b>Forestry/Trust Lands Division</b>		
Contract Timber Harvesting		1,000,000
Fire Suppression Fund		3,228,927
TLMD Trust Administration		1,028,052
Federal Grant Funds	8,546,031	8,103,244

## **10. Related Party Transaction**

Per Title 85, Chapter 1, part 6, MCA, Renewable Resource Grant and Loan Program, the department is eligible to issue GO private sale bonds. Per Title 75, Chapter 5, part 11, MCA, Water Pollution Control SRF program, the department is eligible to

purchase GO private sale bonds. DNRC has applied and receive recycled loan funds from the Water Pollution Control SRF program for non-point source private loans. The loans are GO private sale bonds. The current loans in repayment have interest rates ranging from 3%-4.3% and are repaid over 15 years. See Note #4 Long Term Debt for outstanding GO private bonds balance.

## **11. Fire Suppression Expenditures**

In fiscal year 2015-16, the department incurred significant fire suppression expenditures for the calendar year 2015 fire season of \$19.1 million. This resulted in significant increases in the following expenditure categories: Salaries, Hourly Wages, Other Services, Travel and Rent. Federal agency reimbursements, such as the US Forest Service and the Bureau of Land Management, are estimated at \$6.4 million.

## **12. Treasure State Endowment Regional Water System**

The 2013 Legislative Session appropriated \$17 million to the department in House Bill 11 from the treasure state endowment regional water system state special revenue account. This appropriation was to finance the state's share of the Fort Peck-Dry Prairie rural water authority and the Rocky Boys-North Central Montana regional water authority projects. In fiscal year 2014-5, the Conservation & Resource Development Division expended the remainder of the appropriation in contracted services of \$12.8 million.

## **13. Land Banking**

The Land Banking program sells land to the public and puts the proceeds in a Land Banking Trust Fund. The combined funds from multiple sales can then be used to purchase parcels which produce a higher level of income than the lands sold. This results in a greater income to the trust beneficiaries. In fiscal year 2014-15, approximately \$1.6 million of state trust land was sold and \$1 million was purchased. In fiscal year 2015-16, approximately \$2.6 million of state trust land was sold and \$3 million was purchased.

## **14. Natural Resources Projects**

The 2013 Legislative Session appropriated \$35.5 million to the department in House Bills 6 and 7 from the natural resources projects state special revenue account. This appropriation was to finance the renewable resource and reclamation and development grant programs. In fiscal year 2014-5, the Conservation & Resource Development Division expended the remainder of the appropriation of \$12.9 million

## **15. Permanent Trust Funds**

In fiscal year 2015-16, the permanent trust funds saw an increase in revenues and expenditures over fiscal year 2014-15. This is primarily due to the appreciation of the trust fund bond pool investment of approximately \$21 million.

## **16. Subsequent Events**

In SFY 2017, \$3,000,000 was drawn for a CST taxable bond series 2016A for the renewable resource loan program. The bond was issued on August 2, 2016, and purchased by the Montana BOI.



# **Report on Internal Control and Compliance**





# LEGISLATIVE AUDIT DIVISION

B-1

Angus Maciver, Legislative Auditor  
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors:  
Cindy Jorgenson  
Joe Murray

## REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL SCHEDULES PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

The Legislative Audit Committee  
of the Montana State Legislature:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the Schedules of Changes in Fund Equity & Property Held in Trust, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out of the Department of Natural Resources and Conservation for each of the fiscal years ended June 30, 2016, and 2015, and the related notes to the financial schedules, and have issued our report thereon dated September 22, 2016.

### *Internal Control Over Financial Reporting*

In planning and performing our audit of the financial schedules, we considered the department's internal control over financial reporting to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial schedules, but not for the purpose of expressing an opinion on the effectiveness of the department's internal control. Accordingly, we do not express an opinion on the effectiveness of the department's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial schedules will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a *material weakness*, yet important enough to merit attention by those charged with governance.

Our consideration of internal controls was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

### *Compliance and Other Matters*

As part of obtaining reasonable assurance about whether the Department of Natural Resources and Conservation's financial schedules are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial schedule amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

### *Purpose of this Report*

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the department's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the department's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Respectfully submitted,

/s/ *Cindy Jorgenson*

Cindy Jorgenson, CPA  
Deputy Legislative Auditor  
Helena, MT

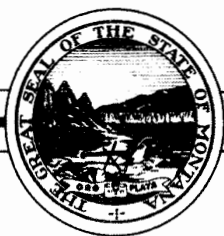
September 22, 2016

DEPARTMENT OF  
NATURAL RESOURCES  
AND CONSERVATION

DEPARTMENT RESPONSE



DEPARTMENT OF NATURAL RESOURCES  
AND CONSERVATION



STEVE BULLOCK, GOVERNOR

1539 ELEVENTH AVENUE

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**STATE OF MONTANA**

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November 1, 2016

Angus Maciver  
Legislative Auditor  
Legislative Audit Division  
P O Box 201705  
Helena, MT 59620-1705

**RECEIVED**

NOV 03 2016

**LEGISLATIVE AUDIT DIV.**

**RE: DNRC Written Response to the Legislative Audit Division Financial-  
Compliance Audit for the Two Fiscal Years Ended June 30, 2016**

**RECOMMENDATION #1**

**We recommend the Department of Natural Resources and Conservation implement internal controls to:**

- A. Review information input to the Trust Land Management System prior to distributing any timber sales revenue to the trusts.**

**Concur.** The department will put a procedure in place whereby TLMS information will be entered by one individual and reviewed by a second individual prior to approval (signature) of the contract or any invoicing of a timber sale.

- B. Retain documentation, including the related contracts, supporting timber permits and limited access timber sales.**

**Concur.** The Forest Management Bureau and Area staff (for timber permits) will verify documentation of fair market value for limited access sales and timber permits and save the information in TLMS. The Forest Management Bureau and Area staff will save Timber Permits' approval documentation (i.e. scan of the signed contract) in TLMS.

**RECOMMENDATION #2**

**We recommend the Department of Natural Resources and Conservation segregate accounting duties related to the approval and review of transactions as needed in order to prevent, detect and correct accounting errors.**

**Concur.** The department will implement additional internal control procedures to verify the proper balances in the proper accounts prior to posting journals and to review the accounts prior to closing fiscal year-end.

### **RECOMMENDATION #3**

**We recommend the Department of Natural Resources and Conservation amend the agreement with the lessee if they are unable to confirm the accuracy and completeness of hydro-electric lease revenue.**

**Conditionally Concur.** DNRC has not been able to find a free, publicly available source for the Mid-Columbia energy contract data as referenced in the contractual lease payments calculation. In past years, DNRC has obtained data from PacifiCorp to show how their calculation was derived. PacifiCorp will no longer voluntarily provide this information. The DNRC legal department is currently working with the MT Attorney General's office to re-assess the agreement with PacifiCorp and efforts will be made to suggest changes.

### **RECOMMENDATION #4**

**We recommend the Department of Natural Resources and Conservation:**

**A. Implement procedures to document receipt of cash-like awards, and**

**Concur.** The department will implement a document where employees will sign for the receipt of gift cards when awarded. This receipt will be attached to the original purchase documentation.

**B. Comply with federal tax law governing inclusion of gifts in employee income as required by the Internal Revenue Service.**

**Concur.** The department will implement a document where, after the employee signs for the receipt of gift cards when awarded, a copy will be sent to DNRC Payroll to report the taxable income.

### **RECOMMENDATION #5**

**We recommend the Department of Natural Resources and Conservation complete a physical inventory at least every two years as required by state policy.**

**Concur.** DNRC has hired an Accountant to handle this task.

### **RECOMMENDATION #6**

**We recommend the Department of Natural Resources and Conservation:**

**A. Comply with state law governing the local government entitlement share, or if appropriate,**

**B. Seek legislation to eliminate state equalization requirements no longer used for entitlement payment calculation.**

**Conditionally Concur.** The department will meet with Dept. of Revenue and Dept. of Administration to discuss the process and determine what statutory requirements are necessary to administer the entitlement share payments.

**RECOMMENDATION #7**

**We recommend the Department of Natural Resources and Conservation comply with state law by annually producing the required Surface and Ground Water Report.**

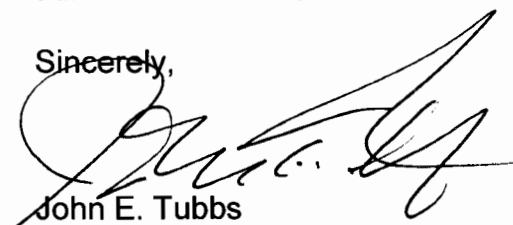
**Concur.** After the 2015 legislative session and the completion of the final federal reserved water right compact negotiations, the Department shifted resources from the negotiation and adoption of water right compacts to the implementation of adopted compacts. The Department is now in compliance and will continue to remain in compliance by preparing annual reports in accordance with Article IV.A.5.a of the Chippewa Cree Tribe-Montana Compact.

**RECOMMENDATION #8**

**We recommend the Department of Natural Resources and Conservation comply with state law by adhering to timelines related to water permit reviews.**

**Partially concur.** In FY 2016, of the 114 applications received, the Department did not notify 3 applicants that their applications had deficiencies within 180 days per 85-2-302(5). As a result, those 3 applications have been treated as correct and complete after the 180 day deadline passed per 85-2-302(5). The Department is working on preliminary determinations on those applications. In FY 2015, of the 114 applications received, the Department did not make a preliminary determination within 120 days on 1 application. The preliminary determination was made on the 140th day. The Department has adopted additional protocols to ensure that the Department will not miss future statutory deadlines. Those protocols include additional automatic notification being sent to multiple people within the Department including the responsible regional manager, the new appropriation program manager, and the deputy administrator of the Water Resources Division as deadlines approach.

Sincerely,

A handwritten signature in black ink, appearing to read 'John E. Tubbs', is written over a large, stylized circular flourish.

John E. Tubbs  
Director